The Pakistan Credit Rating Agency Limited

Rating Report

Hi-Tech Edible Oils (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
09-Feb-2021	BBB	A2	Stable	Maintain	-
10-Feb-2020	BBB	A2	Stable	Maintain	-
29-Aug-2019	BBB	A2	Negative	Maintain	-
27-Mar-2019	BBB	A2	Negative	Maintain	-
25-Sep-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's edible oil industry is heavily reliant on imports since key imported raw materials account for ~80% of the cost of production. Additionally, low domestic oil seed production and lower yields have pushed farmers away from oil seed, further increasing dependence on imports. Demand for edible oil along with sales and recovery of soy meal was impacted during lockdown in the later half of FY20 due to Covid outbreak. However, being a staple food item, edible oil demand from household did not drop. Lately, demand from all avenues for edible oil has picked up. Also, soy meal recovery has improved supported by increase in demand, in turn prices of poultry products. On the supply side, the key raw materials – oil seed – are imported primarily from USA and Brazil. Industry players have sufficient inventories to fulfill demand. International prices of soybean oil seed have picked up (~51%), during FY21, while the rupee has depreciated around 9% since Jan-20. Sales are expected to remain stable. Margins and profitability will improve for players in soybean oil segment. This along with interest rate cut and SBP initiatives like restructuring/deferment of loans will provide sufficient respite to the industry players.

The ratings reflect the Company’s association with Hi-Tech Group, one of the major integrated players in Pakistan’s poultry and allied industry. Topline was supported by improved semi-refined oil and meal prices. However, high dependence on imported oilseeds made the Company susceptible to inherent risk of currency fluctuations and prices of key raw material. Timely passing on the increased cost led to better margins. Meanwhile, high finance cost eroded the Company's profitability. The Company has a highly leveraged structure, though leveraging decreased slightly on YOY basis. Moreover, high inventory levels and its associated financing requirements further stretched the Company’s financial profile.

The ratings are dependent on the Company's ability to prudently manage liquidity and debt structure. Improvement in margins and ensuing coverages while, ensuring working capital discipline, remains critical for the ratings. Any deterioration in profits, diluting coverages, is likely to have adverse impact on the Company's ratings.

Disclosure	
Name of Rated Entity	Hi-Tech Edible Oils (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Edible Oil(Feb-20)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Hi-Tech Edible Oils (Private) Limited ('Hi-Tech Oil' or 'The Company) was incorporated as a Private Limited Company in 2002.

Background The Company is an backward integrated venture of Hi-Tech Group, which has presence across the poultry supply chain. In 1980, the Group started from a small scale poultry breeder business and later diversified vertically. Hi-Tech Oils became formally operational in 2006. However, its edible oil extraction mill was set up in Sahiwal in 2007.

Operations The Company is primarily engaged in the of seed filtering, seed crushing, oil extraction and refining by chemical processes. The Company is ranked among the largest importer of premium quality soybean oilseed, from Brazil and USA. Currently, the Company has three solvent extraction units with a combined annual capacity of 365,000MT. In FY20, the Company has produced 201,026MT (FY19: 215,470MT) which translates into the utilization of 55% (FY19: 59%). The Group's registered office is located in Shadman Chowk, Jail Road, Lahore. While, the oil extraction facility is located at Main GT Road, Sahiwal.

Ownership

Ownership Structure Ownership of the Company is divided equally between four founding members of the Company represented by Dr. Muhammad Arshad, Dr. Anwar Mahmood Randhawa, Dr. Muhammad Asim and Dr. Hafiz Abdul Qayyum. Sponsors are close acquaintances with no family relationship.

Stability Ownership structure of the business is seen as stable as no changes in ownership are expected. The second generation is gradually being inducted in the business.

Business Acumen The Company is a venture of Hi-Tech Group, which has an established presence in Pakistan’s poultry and allied industry. The Group’s flagship entity, Hi-Tech Feeds, has grown to become one of the Country’s leading feed mills catering to its clients in the poultry industry.

Financial Strength The Group operates a total of four entities in the poultry segment. Moreover, the Group has business interests in edible oil and rice. Sponsors willingness to support the business and a considerable equity base of the Group bodes well for the Company.

Governance

Board Structure Board of Directors comprises four Executive Directors. Absence of Non-executive Director and lack of independent oversight indicates a room for improvement in the Company’s governance framework.

Members’ Profile Board members are qualified individuals possessing significant industry knowledge relating to poultry and allied industries. Dr. Anwar Mehmood Randhawa, Chairman of all Group Companies, is a Doctor of Veterinary Medicine and holds 44 years of experience. Dr. Anwar was a member of Standing Committee (North) in Pakistan Poultry Association. Currently he is the Chairman of Pakistan's Solvent Extractions Association.

Board Effectiveness Keeping in view the size of the Company’s Board, absence of sub-committees may not impact Board's effectiveness. During FY20, various informal Board meetings were though, minutes of these meetings were not formally maintained.

Financial Transparency Hameed Zahid & Co. Chartered Accountants, who are not rated by the SBP but hold a satisfactory QCR rating, are appointed as the external auditor of the Company. The firm has expressed an unqualified opinion on the financial statements for the year ending Jun-20.

Management

Organizational Structure The Company's organogram is structured as per organizational needs. All functions related to production are consolidated under the General Manager for production. Similarly, functions of audit, accounting and marketing are headed by the Chief Financial Officer. Lastly, the IT function is led by a separate head. Subsequently, highest level of authority lies with the Chief Executive Officer.

Management Team Founder of the Group, Dr. Muhammad Arshad, is the Chief Executive Officer. He is a Doctor of Veterinary Medicine and actively participates in international and local seminars relating to poultry, feed milling and pharmaceutical industries. He is supported by a professional management staff.

Effectiveness The Company lacks presence of formal management committees. However, pertinent issues are discussed among management with minutes being captured informally.

MIS Hi-Tech Group has built a customized software in-house to monitor and generate reports relating to the Company’s inventory management, sales, receivables and payables. To ease other functions, many other modules are in development stage. Moreover, Microsoft Excel is used for the compilation of a few reports which are reviewed by the Board frequently.

Control Environment To observe and evaluate business activity, various production data is generated that highlights and enables management to monitor performance at different steps of the production process.

Business Risk

Industry Dynamics Pakistan's edible oil industry is heavily reliant on imports since oilseeds account for ~80% of the cost of production. Additionally, low local oil seed production and lower yields have pushed farmers away from oilseed, further increasing dependence on imports. Demand for edible oil along with sales and recovery of soy meal was impacted during lockdown in the later half of FY20 due to Covid outbreak. However, being a staple food item, edible oil demand from household did not drop. Lately, demand from all avenues for edible oil has picked up. Also, soy meal recovery has improved supported by increase in prices of poultry products. On the supply side, oilseeds are imported primarily from USA and Brazil. Industry players have sufficient inventories to fulfill demand. International prices of soybean have picked up (~51%), during FY21, while the rupee has depreciated ~ 9%, since Jan-20. Sales are expected to remain stable. Margins and profitability will improve for players in soybean oil segment. Interest rate cut and SBP initiatives like restructuring/deferment of loans will provide sufficient respite to the industry players.

Relative Position The Company holds an adequate position in the semi-refined oil market with a market share of ~0.8% in terms of revenue and ~1.1% in terms of production. It is yet to penetrate the branded oil segment but the management is working in this dimension.

Revenues Hi-Tech Oil generates revenue by manufacturing and selling semi-refined edible oil and the by-products extracted during the production process. In FY20, the major portion of revenue emanated from soybean meal (~68%) and soybean edible oil (~31%). Additionally, other by-products including soybean hull, soap and other byproducts comprise of a very small portion (1%) of overall sales. During FY20, the top-line witnessed a rise of ~11% and stood at ~PKR 15,646mln (FY19: ~PKR 14,142mln) supported by increase in the meal (~34%) and semi-refined oil (~3%) price.

Margins The Company’s ability to pass on the increased raw material cost to its customers led to improved gross margin (FY20: ~9%, FY19: ~7%). Similarly, the operating margin also increased to ~8% (FY19: ~6%) due to trickle-down effect. However, the higher finance cost (FY20: ~PKR 678mln, FY19: 542mln) on the back of elevated borrowings (FY20: ~PKR 7,786mln, FY19: ~PKR 6,362mln) subdued the impact of higher prices and net margin clocked in at 0.3% (FY19: 0.7%).

Sustainability Edible oil is a staple food item, thus going forward, its demand is anticipated to grow. Keeping this in view, the management is confident to capture a significant share of the industry. However, growth in edible oil sector may not materialize in near future due to Corona Virus pandemic

Financial Risk

Working Capital Hi-Tech Edible Oils working capital management is supported through short-term running finance facility. Working capital requirements have been increasing over the years in-line with expanding operations. Consequently, the inventory days surged to 145 days in FY20 (FY19: 129 days). The Company makes credit sales, of around 60 days, to sustain its market share. Thus, trade receivable days stood at 63 days (FY19: 51 days). Meanwhile, the trade payable days increased to 9 days in FY20 (FY19: 2 days) as some of the raw material was in transit. This led to deterioration in net working capital days (FY20: 199 days, FY19: 179 days). Relative increase in short-term borrowings deteriorated the borrowing cushion of the the Company.

Coverages During FY20, the free cashflows of the Company saw a rise to ~PKR 1,019mln (FY19: ~PKR 826mln) on the back of improved profitability. Meanwhile, the finance cost increased to ~PKR 678mln in FY20 (FY19: ~PKR 542mln) because of elevated borrowings. Resultantly, the interest coverage ratio showed no change and stood at 1.5x in FY20 (FY19: 1.5x). Similarly, the core and total operating coverage remained stable at 1.5x (FY19: 1.5x) and 1.5x (FY19: 1.5x), respectively.

Capitalization Hi-Tech Oils has a highly leveraged capital structure with a leveraging ratio of ~76% in FY20. Short term borrowings constitutes ~99% of the total borrowings. During FY20, the borrowings of the Company increased to ~PKR 7,786mln (FY19: ~PKR 6,362mln) to support its working capital requirement.

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Financial Summary
PKR mln

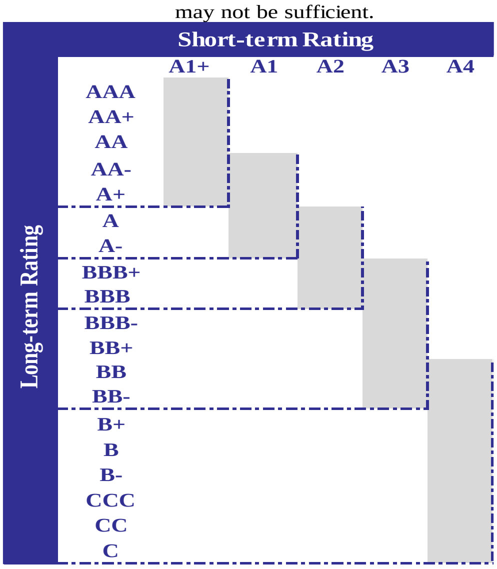
Hi-Tech Edible Oils (Pvt.) Limited	Jun-20	Jun-19	Jun-18
Edible Oil	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	1,573	1,607	477
2 Investments	-	-	-
3 Related Party Exposure	178	158	145
4 Current Assets	9,678	8,296	8,442
a Inventories	*6,467*	*4,754*	*5,245*
b Trade Receivables	*2,780*	*2,636*	*1,341*
5 Total Assets	11,429	10,061	9,064
6 Current Liabilities	1,104	617	365
a Trade Payables	*678*	*83*	*60*
7 Borrowings	7,786	6,362	6,899
8 Related Party Exposure	-	590	590
9 Non-Current Liabilities	29	29	30
10 Net Assets	2,509	2,463	1,180
11 Shareholders' Equity	2,509	2,463	1,180
B INCOME STATEMENT			
1 Sales	15,646	14,142	11,795
a Cost of Good Sold	*(14,210)*	*(13,173)*	*(11,139)*
2 Gross Profit	1,436	969	656
a Operating Expenses	(130)	(127)	(119)
3 Operating Profit	1,305	842	537
a Non Operating Income or (Expense)	*(342)*	*(15)*	*(22)*
4 Profit or (Loss) before Interest and Tax	963	827	515
a Total Finance Cost	*(687)*	*(544)*	*(280)*
b Taxation	*(229)*	*(182)*	*(139)*
6 Net Income Or (Loss)	47	101	96
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*1,019*	*826*	*479*
b Net Cash from Operating Activities before Working Capital Changes	*319*	*359*	*240*
c Changes in Working Capital	*(1,192)*	*(2,368)*	*(899)*
1 Net Cash provided by Operating Activities	(873)	(2,009)	(659)
2 Net Cash (Used in) or Available From Investing Activities	(22)	(3)	(76)
3 Net Cash (Used in) or Available From Financing Activities	726	1,234	1,785
4 Net Cash generated or (Used) during the period	(169)	(778)	1,050
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	10.6%	19.9%	58.8%
b Gross Profit Margin	9.2%	6.9%	5.6%
c Net Profit Margin	0.3%	0.7%	0.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-1.1%	-10.9%	-3.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/S*	1.9%	5.6%	10.4%
2 Working Capital Management			
a Gross Working Capital (Average Days)	208	180	215
b Net Working Capital (Average Days)	199	179	213
c Current Ratio (Current Assets / Current Liabilities)	8.8	13.4	23.2
3 Coverages			
a EBITDA / Finance Cost	1.7	1.6	2.1
b FCFO / Finance Cost+CMLTB+Excess STB	1.5	1.5	1.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.3	2.1	2.9
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	75.6%	73.8%	86.4%
b Interest or Markup Payable (Days)	67.0	98.3	92.6
c Entity Average Borrowing Rate	9.1%	8.1%	4.8%

Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating	
Scale	**Definition**
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating	
Scale	**Definition**
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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